WINDFALL PROFIT TAX OPTIONS

Prepared for the Use of the Conferees by the
Staff of the Joint Committee on Taxation.

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Proposal to Merge Tiers One and Two

Description of bills

In both the House and Senate versions of the windfall profit tax, tiers 1 and 2 consist of oil discovered before 1979. In both bills, the general rule is that tier 1 oil is the quantity of oil produced on a property below the amount represented by a 1-1/2-percent decline curve. However, each bill contains special rules which put certain kinds of oil into tier 2: Marginal oil and front-end tertiary oil are automatically in tier 2 in both bills, and the Senate bill puts high water-cut oil, deep marginal oil and Cook Inlet oil into tier 2 as well. After June 1984, the decline curve causes tier 1 to phase into tier 2.

The rules for determining the tax on tier 2 oil are different in the two bills. The tax rate is 60 percent in the House version and 75 percent in the Senate version. The base price in the House bill is the May 1979 ceiling price (which averaged $13.00) and rises by $3 between 1986 and 1990. In the Senate bill, the base price is the May 1979 ceiling price in 1980, but that price is reduced by $0.25 in subsequent years and there is no $3 increase after 1986.

Complexity

The need to distinguish between tiers 1 and 2 is responsible for much of the complexity of the tax. Merging the two tiers, i.e., eliminating tier 1 and taxing all of its oil under tier 2 rules, would completely eliminate the following complexities: (1) the 1-1/2-percent decline curve, which requires computation of the base production control level (under one of three options in the Senate bill), the decline rate (under one of two options in the Senate bill), and cumulative deficiencies; (2) the category of marginal properties; (3) the category of front-end tertiary oil; (4) the category of high water-cut oil in the Senate bill; (5) the category of deep marginal oil in the Senate bill; and (6) the category of Cook Inlet oil in the Senate bill.

Revenue effect

The following table shows 12 options for a merged tier. In each case, the revenue impact is shown both as the revenue gain above the House bill treatment of tiers 1 and 2 and the revenue loss below the Senate bill treatment of tiers 1 and 2 between 1980 and 1990. The options with a $12.80 base price assume that the base price equals the May 1979 ceiling price in 1980 and that this price is reduced by $0.20 after 1980, as in the Senate bill.

($ billions)

	With $3 phaseup of base price		Without $3 phaseup of base price	
Merged tiers	Gain from House	Loss from Senate	Gain from House	Loss from Senate
$13.00 base, 65% rate	+4.7	-18.1	+6.0	-16.8
$13.00 base, 70% rate	+11.3	-11.5	+12.7	-10.1
$13.00 base, 75% rate	+18.0	-4.8	+19.5	-3.3
$12.80 base 65% rate	+5.8	-17.0	+6.9	-15.9
$12.80 base, 70% rate	+12.5	-10.3	+13.8	-9.0
$12.80 base, 75% rate	+19.3	-3.5	+20.6	-2.2

Impact on particular producers

If there is a merger of tiers 1 and 2, then as long as the base price is set between $12.75 and $13.00 and the tax rate is between 60 percent and 75 percent, no producer will pay more tax on tier 1 or tier 2 oil than he would have paid under the Senate bill. Some producers with a disproportionate amount of tier 1 oil could benefit from the merger in the sense that they would pay less tax than they would have paid under either bill. How many producers would fit into this category would depend on the precise tax rate and base price for the merged tier.

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WINDFALL PROFIT TAX OPTIONS

This memorandum outlines alternative ways to structure the windfall profit tax in order to raise $227.3 billion between 1980 and 1990 in line with the agreement reached by the conferees before Christmas. The staff has not attempted to fine-tune each option so that it raises exactly $227.3 billion; this can be done easily once the conferees make the basic decisions about the structure of the tax.

In order to limit the number of options, the staff has held certain things constant across all the options. The options all assume that tier 1 is merged into tier 2, that the tier 2 base price is set at $12.80 (5 cents above the Senate bill and 20 cents below the House bill), and that the $3 increase in the tier 2 base price after 1986 is omitted (as in the Senate bill). This proposal to merge tiers 1 and 2 is intended to simplify the tax and is described more fully in the attached paper. All the options also assume that North Slope Alaskan oil is taxed in tier 2, as in the Senate bill. Stripper oil is taxed in tier 3 at a 60-percent rate, which is the way it is treated in both bills. Finally, none of the options include the Senate bill's exemption for Indian tribes, charitable organizations or front-end tertiary oil. Changes in the treatment of Alaskan oil or exemptions for Indians, charities or front-end tertiary oil could be added as part of the fine-tuning process.

For newly discovered oil, heavy oil, and incremental tertiary oil, the options all have a base price of $16.30, adjusted for inflation plus a 2-percent kicker. This is the base price for new and tertiary oil in the House bill and for tertiary and heavy oil in the Senate bill. (New oil has a $19.30 base price in the Senate bill.) Using the same tax rate and base price for these three categories of oil would simplify the tax because producers whose oil fell into any one of the three categories would not have to worry about whether the oil also qualified for one of the other two. Also, there does not seem to be a compelling economic reason why any one of these three categories deserves better or worse treatment than the other two.

The options all assume that royalty owners are not eligible for any special tax rate or exemption for independent producers. Exclusion of royalty owners complicates an independent producer exemption or special tax rate, but many of these complexities would be eliminated if special treatment for independents is limited to previously discovered oil. Thus, several options are presented in which the independent producers receive a preferential tax rate or exemption on their old and stripper oil but not on their new, heavy or tertiary oil.

The staff is preparing additional options. One omission from this set of options is options with exemptions or special rates for levels of production below 1,000 barrels per day. A second omission is options involving exemptions only for stripper oil produced by independents. These will be made available as soon as possible.

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Proposal 1/	Revenue gain 1980-90 ($ billions)
1. 70% rate on merged tiers 1 and 2 20% rate on new, tertiary and heavy oil No independent producer exemption Deny percentage depletion on windfall	225.0
2. 65% rate on merged tiers 1 and 2 25% rate on new, tertiary and heavy oil No independent producer exemption Deny percentage depletion on windfall	225.3
3. 70% rate on merged tiers 1 and 2 30% rate on new, tertiary and heavy oil No independent producer exemption Retain full percentage depletion	230.4
4. 65% rate on merged tiers 1 and 2 35% rate on new, tertiary and heavy oil No independent producer exemption Retain full percentage depletion	230.6
5. 70% rate on merged tiers 1 and 2 25% rate on new, tertiary and heavy oil No independent producer exemption Deny depletion on one-half of windfall	227.7
6. 70% rate on merged tiers 1 and 2 40% rate on new, tertiary and heavy oil Tax 1,000 b/d at half rates (i.e., 35% on tiers 1 and 2, 30% on stripper and 20% on new, tertiary and heavy oil) Retain full percentage depletion	229.2
7. 65% rate on merged tiers 1 and 2. 45% rate on new, tertiary and heavy oil Tax 1,000 b/d at half rates Retain full percentage depletion	228.9
8. 70% rate on merged tiers 1 and 2 35% rate on new, tertiary and heavy oil Tax 1,000 b/d at 35% Retain full percentage depletion	229.4
9. 70% rate on merged tiers 1 and 2 30% rate on new, heavy and tertiary oil Tax 1,000 b/d at 30% Deny percentage depletion on windfall	231.6
10. 65% rate on merged tiers 1 and 2 40% rate on new, tertiary and heavy oil Tax 1,000 b/d at 40% Retain full percentage depletion	232.0
11. 70% rate on merged tiers 1 and 2 35% rate on new, tertiary and heavy oil Tax 1,000 b/d of oil in tiers 1, 2 and 3 at half rates (i.e., 35% for tiers 1 and 2 and 30% for stripper oil) Retain full percentage depletion	228.3

1/ All options assume a $13.00 base price for tier 2 in 1980 and a $12.80 base price thereafter, inclusion of North Slope Alaskan oil in tier 2, inclusion of stripper oil in tier 3 with a 60-percent rate, a $16.30 base price for new, tertiary and heavy oil adjusted for inflation plus a 2-percent kicker, and no exemptions for Indian tribes, charities or front-end tertiary oil.

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